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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

NO. 689

FORT PITT BREWING COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

Petitioner prays that a Writ of Certiorari issue to review the Judgment (R. 92) entered in the above entitled case on February 11, 1954, by the United States Court of Appeals for the Third Circuit at No. 11,133, affirming the Decision of the Tax Court of the United States entered April 6, 1953 (R. 48a).

OPINIONS BELOW.

The Findings of Fact and Opinion of the Tax Court (R. 3a-21a) are officially reported at 20 T. C. ——, No. 1. The Opinion of the Court of Appeals (R. 84-91) has not been reported.

JURISDICTION.

The Judgment of the Court of Appeals was entered on February 11, 1954 (R. 92). A Petition for Rehearing was filed March 8, 1954 (R. 95-117). On March 11, 1954, the Court of Appeals denied the Petition for Rehearing (R. 118). The jurisdiction of this Court is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 869, 928 (28 U.S.C., Sec. 1254).

QUESTIONS PRESENTED.

1. Did the Tax Court and the Court of Appeals commit reversible error in concluding that the Commissioner of Internal Revenue may ignore property rights governed by contract and the requirements of state law as to such property rights and charge to Petitioner as "earnings" as though received by it under a claim of right and without restriction as to disposition certain amounts of deposits on returnable containers actually received by Petitioner in each of its fiscal years ended October 31, 1942, and October 31, 1943, under no claim of right and always during said years held by it subject to a definite, written obligation to return to its customers upon the return by them to Petitioner of its containers for which the deposits were made?

2. Did the Tax Court and the Court of Appeals commit reversible error in concluding that the Tax Court may disregard the Commissioner of Internal Revenue's acceptance of the accrual method of accounting used by Petitioner in years prior to the two taxable years here involved respecting deposits received and refunds thereof made on returnable containers as clearly reflecting

its income for Federal income tax purposes and with the method of accounting exactly the same in the two years here involved as in such prior years, reject the accrual method of accounting used in such tax years and place Petitioner on a cash receipts and disbursements method of accounting on container deposits and refunds thereof?

3. Did the Tax Court and the Court of Appeals commit reversible error in concluding that Section 41 of the Internal Revenue Code gives the Commissioner of Internal Revenue the right to create "gross income"?

4. Did the Tax Court and the Court of Appeals commit reversible error in concluding that the Tax Court may base its determination of tax liability upon a contention made by counsel for the Commissioner of Internal Revenue at the hearing before the Tax Court without any pleading upon which to base such contention or any issue drawn thereon?

5. Did the Tax Court and the Court of Appeals commit reversible error in concluding that the Tax Court may, on the basis of its determination that the excess of container deposits received over deposits refunded in each of the two years here involved represented gross income, charge to Petitioner in such years amounts which on the Tax Court's own determination represent income applicable to years prior to those here involved?

6. On the basis of the Tax Court's finding and concluding that the excess of deposits received over deposits refunded in the fiscal year ended October 31, 1942, of $82,971.60 represented gross income, did the Tax Court commit reversible error (a) in failing to

find and conclude that such excess deposits represented gain from the sale, exchange or involuntary conversion of depreciable property held for more than 18 months and (b) in determining Petitioner's Excess Profits Tax liability and the deficiency therein for such year, did the Tax Court commit such error in determining Petitioner's Excess Profits Net Income in failing to exclude therefrom, under Section 711(a)(1)(B) of the Internal Revenue Code, as amended by Section 208 of the Revenue Act of 1942, said $82,971.60 as the excess of recognized gains from the sale, exchange or involuntary conversion (as the result of destruction, in whole or in part) of property held for more than 18 months, of the character which is subject to the allowance for depreciation under Section 23 (l) of the Internal Revenue Code, over the recognized losses from the sale, exchange or involuntary conversion of such property?

7. On the basis of the Tax Court's finding and concluding that the excess of deposits received over deposits refunded in the fiscal year ended October 31, 1943, of $181,196.25 represented gross income, did the Tax Court commit reversible error (a) in determining Petitioner's Income and Declared Value Excess-Profits Tax liability and the deficiency therein for such year in failing to treat said $181,196.25 as recognized gain from involuntary conversion as the result of destruction, in whole or in part, of property used in the trade or business of Petitioner and thus as a gain from the sale or exchange of capital assets held more than 6 months under Section 117(j) of the Internal Revenue Code, and in failing to apply to such recognized gain the alternative taxes provided by Section 117(c)(1) of the Internal Revenue Code, and (b) in determining

Petitioner's Excess Profits Tax liability and the deficiency therein for the fiscal year 1943 in failing to exclude from Petitioner's Excess Profits Net Income for said year under Section 711(a)(1)(B) of the Internal Revenue Code, as amended by Section 207(a) of the Internal Revenue Act of 1942, said $181,196.25 as a long-term capital gain?

8. Did the Court of Appeals commit reversible error in affirming the Tax Court?

STATUTES AND REGULATIONS INVOLVED.

The pertinent portions of the Statutes and Regulations involved are set out in the Appendix, *infra*, pages 46-52.

STATEMENT.

Petitioner is a corporation organized under and existing by virtue of the laws of the Commonwealth of Pennsylvania, with its principal place of business at Sharpsburg in said Commonwealth (R. 10a).

During its fiscal years ended October 31, 1942, and October 31, 1943, Petitioner was engaged in the Commonwealth of Pennsylvania in the brewing of malt beverages, at its plants located at Sharpsburg and Jeannette in said Commonwealth. Its products in each of said years were sold in barrels, half barrels, quarter barrels and eighth barrels and bottles packaged in cartons and cases (R. 10a).

Petitioner's Corporation Income and Declared Value Excess-Profits Tax Returns (Form 1120) and Corpora-

tion Excess Profits Tax Returns (Form 1121) for its fiscal years ended October 31, 1942, and October 31, 1943, were filed with the Collector of Internal Revenue for the 23rd District of Pennsylvania, at Pittsburgh. (R. 11a).

The method of accounting regularly employed in keeping the books of Petitioner during its fiscal years ended October 31, 1942, and October 31, 1943, was the accrual method, and Petitioner's net income for said fiscal years as shown in its aforesaid tax returns was computed in accordance with such method of accounting. (R. 11a).

Throughout its fiscal years ended October 31, 1942, and October 31, 1943, Petitioner was the owner and holder of a valid license issued by the Commonwealth of Pennsylvania, Pennsylvania Liquor Control Board to produce and manufacture malt or brewed beverages and to transport, sell and deliver malt or brewed beverages at or from one or more places of manufacture or storage only in original containers in quantities of not less than a case of 24 bottles, each of said bottles containing seven fluid ounces or more, or a case of 12 bottles each of said bottles containing 24 fluid ounces or more. (R. 11a).

Section 23 (V) of the re-enacted and amended Beverage License Law (Act No. 372) of the General Assembly of the Commonwealth of Pennsylvania (being the Act of June 16, 1937, Pamphlet Laws 1827, as amended) and as in effect during Petitioner's fiscal years ended October 31, 1942, and October 31, 1943, provided:

"Section 23. Unlawful Acts.—It shall be unlawful—* * *

"(V) For any licensee, or his servants, agents or employees, to sell, or offer to sell, or purchase or

receive, any malt or brewed beverages except for cash, excepting credits extended by a hotel or club to bona fide registered guests or members. No right of action shall exist to collect any claims for credit extended contrary to the provisions of this clause. Nothing herein contained shall prohibit a licensee from crediting to a purchaser the actual price charged for original containers returned by the original purchaser as a credit on any sale, or from refunding to any purchaser the amount paid by such purchaser for such containers, or as a deposit on such containers when title is retained by the vendor if such containers have been returned to the manufacturer, distributor, importing distributor or other vendor. Nothing herein contained shall prohibit a manufacturer from extending usual and customary credit for malt or brewed beverages sold to customers or purchasers who live or maintain places of business outside of the Commonwealth of Pennsylvania, when the malt or brewed beverages so sold are actually transported and delivered to points outside of the Commonwealth: Provided, however, That as to all transactions affecting malt or brewed beverages to be resold or consumed within this Commonwealth, every licensee shall pay and shall require cash deposits on all returnable original containers which contain not more than one hundred twenty-eight fluid ounces." (R. 12a).

Section 2 (g) of said Act as in effect during Petitioner's fiscal years ended October 31, 1942, and October 31, 1943, provided:

"Section 2. Definitions.—The following words

and terms as used in this act, shall be construed as defined in this section:

* * * * * * *

(g) The term 'original containers' means and includes bottles, casks, kegs or other suitable containers that have been securely capped, sealed or corked by the manufacturer at the place of manufacture, with the name and address of the manufacturer permanently affixed to the bottle, cask, keg or other container, or to the cap or cork used in sealing same, or to a label securely affixed to a bottle." (R. 13a).

Regulation R-37-22, July 8, 1937, pertaining to cash deposits on returnable original containers of malt or brewed beverages, as issued by Commonwealth of Pennsylvania, Pennsylvania Liquor Control Board, and effective July 15, 1937, is shown as Exhibit 1-A at R. 16a. (R. 13a).

Regulation R-42-22-B, January 6, 1942, pertaining to cash deposits on returnable original containers of malt or brewed beverages, as issued by Commonwealth of Pennsylvania, Pennsylvania Liquor Control Board, rescinding Regulation R-37-22, and effective February 9, 1942, is shown as Exhibit 2-B at R. 19a. This regulation was effective during the balance of the year 1942 and all of the year 1943. (R. 13a).

At the times of all sales of its products during its fiscal years ended October 31, 1942, and October 31, 1943, Petitioner required the purchasers thereof to deposit with it various amounts for the return of the containers in which Petitioner's products were delivered, Petitioner's

invoices to its customers on all such sales having printed thereupon the following:

> "Deposit for return of package is as follows: Barrels $8.00, Half Barrels $6.00, Quarter Barrels $4.00 and Eighth Barrels $1.00 each, Cartons of 2 Dozen Small Bottles 50¢, Case of 2 Dozen Small Bottles 75¢, Bottles short in cases returned will be charged at rate of 2¢ for small bottles. Purchaser buys only the beer delivered and billed. Bottles, Cases, Kegs, Etc. containing the products delivered therein are never sold but remain absolute property of Brewing Company. Deposit for return of packages repaid purchaser for number delivered only on return of packages to Brewing Company. Purchaser agrees to these conditions." (R. 14a).

During its fiscal years ended October 31, 1942, and October 31, 1943, Petitioner on sales of its products received deposits on its containers, in accordance with the above quoted agreement upon its invoices and as to all returnable original containers containing not more than one hundred twenty-eight fluid ounces in accordance with the aforesaid provisions of the Pennsylvania Beverage License Law and the regulations of the Pennsylvania Liquor Control Board, of amounts aggregating $4,822,919.50 and $5,940,221.75 in said years respectively.

During its fiscal years ended October 31, 1942, and October 31, 1943, Petitioner on returns of containers refunded on account thereof, in accordance with the above quoted agreement upon its invoices and as to all returnable original containers containing not more than one hundred twenty-eight fluid ounces in accordance with

the aforesaid provisions of the Pennsylvania Beverage License Law and the regulations of the Pennsylvania Liquor Control Board, amounts aggregating $4,739,947.90 and $5,759,025.50 in said years respectively. (R. 14a).

At all times in each of its said fiscal years ended October 31, 1942, and October 31, 1943, Petitioner kept and maintained a liability account upon its books of account captioned "Reserve for Returnable Containers", wherein it credited all of the aforesaid container deposits aggregating $4,822,919.50 and $5,940,221.75 in said years respectively and debited all of the aforesaid refunds on account of containers returned aggregating $4,739,947.90 and $5,759,025.50 in said years respectively. (R. 15a).

In each of its said fiscal years ended October 31, 1942, and October 31, 1943, the excess of deposits received by Petitioner on returnable containers over deposits refunded in such years, namely, $82,971.60 and $181,196.25, was shown on Petitioner's books of account and its aforesaid United States Corporation tax returns for said years as a liability under the caption "Reserve for Returnable Containers." (R. 15a).

The method of accounting regularly employed in keeping the books of Petitioner during its fiscal years ended October 31, 1936, though October 31, 1943, was the accrual method, and Petitioner's net income for said fiscal years was computed in accordance with such method of accounting. (R. 15a).

The deposits required were in each case less than the cost of the containers. There was no time limit within which containers could be returned for refund. (R. 4a).

Petitioner never transferred any amount to surplus from its Reserve for Returnable Containers. The balance in that Reserve was shown at all times as a liability of Petitioner. (R. 6a).

Petitioner maintained a separate account for the cost of returnable containers and reserves for depreciation thereon. The cost of containers, the reserve for depreciation and undepreciated cost as shown on Petitioner's books for the years 1936 through 1943 are shown in the Transcript of Record herein, p. 6a.

The entire cost of its containers has been or is being taken by Petitioner as deductions for depreciation on its returns. (R. 6a).

The Commissioner, in determining the deficiencies, added to income, as disclosed by the returns, $82,971.60 for 1942 and $181,196.25 for 1943. The explanation for 1942 was "It is determined that the excess of deposits received on returnable containers over deposits refunded in the fiscal year ended October 31, 1942, or $82,971.60, should be included in your gross income." A similar explanation was given for the 1943 adjustment. (R. 7a).

The Tax Court affirmed the determination of the Commissioner (R. 7a-10a) and the Court of Appeals affirmed the Tax Court (R. 91).

SPECIFICATIONS OF ERRORS TO BE URGED.

In affirming the Decision of the Tax Court Petitioner avers the Court of Appeals commited errors of law as follows:

1. In failing to conclude that the Tax Court committed reversible error in concluding that the Commissioner of Internal Revenue may ignore property rights governed by contract and the requirements of state law as to such property rights and charge to Petitioner as "earnings" as though received by it under a claim of right and without restriction as to disposition, certain amounts of deposits on returnable containers actually received by Petitioner in each of the two years here involved under no claim of right and always during said years held by it subject to a definite written obligation to return to its customers upon the return by them to Petitioner of its containers for which the deposits were made, the conclusion of the Court of Appeals that such excess of deposits received over deposits returned in such years is includible in gross income being a clear-cut mistake of law, because in conflict with the decisions of this Court in *North American Oil Consolidated v. Burnet*, 286 U.S. 417 (1932), *Commissioner v. Wilcox*, 327 U.S. 404 (1946), *United States v. Lewis*, 340 U.S. 590 (1951) and *Healey, et al. v. Commissioner*, 345 U.S. 278 (1953), since none of such deposits were received under a claim of right and without restriction as to the disposition thereof and thus not income.

2. In failing to conclude that the Tax Court committed reversible error in concluding that the Tax Court may disregard the Commissioner of Internal Revenue's

acceptance of the accrual method of accounting used by Petitioner in years prior to the two years here involved respecting deposits received and refunds thereof made on returnable containers as clearly reflecting its income for Federal income tax purposes and with the method of accounting exactly the same in the two years here involved as in such prior years, reject the accrual method of accounting used in such years and place Petitioner on a cash method of accounting so far as container deposits and refunds are concerned, the conclusion of the Court of Appeals that Petitioner's recording its container deposits received in its fiscal years ended in 1942 and 1943 as true deposits, liabilities, rather than as income did not properly reflect the transactions therein for income tax purposes being in conflict with the decision of the Court of Appeals for the Fifth Circuit in *Wichita Coca-Cola Bottling Company v. United States*, 61 F. Supp. 407 (U.S.C., N.D. Tex. 1945), aff'd. 152 F. (2d) 6 (C.C.A. 5th, 1945), Cert. denied, 327 U.S. 806 (1946).

3. In failing to conclude that the Tax Court committed reversible error in concluding that Section 41 of the Internal Revenue Code gives the Commissioner of Internal Revenue the right to create "gross income".

4. In failing to conclude that the Tax Court committed reversible error in concluding that the Tax Court may base its determination of tax liability upon a contention made by counsel for the Commissioner of Internal Revenue at the hearing before the Tax Court without any pleading upon which to base such contention or any issue drawn thereon.

5. In failing to conclude that the Tax Court committed reversible error in concluding that the Tax Court may on the basis of its determination that the excess of container deposits received over deposits refunded in each of the two years here involved represented gross income, charge to Petitioner in such years amounts which on the Tax Court's own determination represent income applicable to years prior to those here involved, the conclusion of the Court of Appeals on Specifications of Errors 3, 4, and 5 herein that the excess of deposits received over deposits returns in Petitioners fiscal years ended in 1942 and 1943 is includible in gross income being a clear-cut mistake of law, because the "accounting theory" advanced by the Court of Appeals to substantiate its conclusion not only is not supported by statutory or case law or the Commissioner of Internal Revenue's Regulations under the Internal Revenue Code, but conflicts with the decision of the Court of Appeals for the Third Circuit in *Commissioner v. Frame,* 195 F. (2d) 166, (1952), as well as with the decisions of Courts of Appeals, *inter alia, Commissioner v. Mnookin,* 184 F. (2d) 89, C.A. 8th (1950); *Commissioner v. Schuyler,* 196 F. (2d) 85, C.A. 2d (1952); *Welp v. U.S.,* 201 F. (2d) 128, C.A. 8th (1953); *Caldwell v. Commissioner,* 202 F. (2d) 112, C.A. 2d (1953); and *Commissioner v. Dwyer,* 203 F. (2d) 52, C.A. 2d (1953), all of which hold that the discretion which the Commissioner of Internal Revenue has under Section 41 of the Code to make such computations as will clearly reflect income does not empower him to add to a taxpayer's gross income for a given year an item which belongs to an earlier year.

6. In failing to conclude, on the basis of the Tax Court's finding and concluding that the excess of container deposits received over deposits refunded in the fiscal year ended in 1942 of $82,971.60 represented gross income, that the Tax Court committed reversible error (a) in failing to find and conclude that such excess deposits represented gain from the sale, exchange or involuntary conversion of depreciable property held for more than 18 months and (b) in determining Petitioner's Excess Profits Tax liability and the deficiency therein for such year in failing to exclude from Petitioner's Excess Profits Net Income under Section 711(a)(1)(B) of the Internal Revenue Code, as amended by Section 208 of the Revenue Act of 1942 said $82,971.60 as the excess of recognized gains from the sale, exchange or involuntary conversion (as the result of destruction, in whole or in part) of property held more than 18 months, of the character which is subject to the allowance for depreciation under Section 23(l) of the Revenue Code, over the recognized losses from the sale, exchange or involuntary conversion of such property.

7. In failing to conclude, on the basis of the Tax Court's finding and concluding that the excess of deposits received over deposits refunded in the fiscal year ended in 1943 of $181,196.25 represented gross income, that the Tax Court erred (a) in determining Petitioner's Income and Declared Value Excess-Profits Tax liability and the deficiency therein for such year in failing to treat said $181,196.25 as recognized gain from involuntary conversion as the result of destruction of property used in the trade or business of Petitioner and thus a

gain from the sale or exchange of capital assets held more than 6 months under Section 117(j) of the Internal Revenue Code and in failing to apply to such recognized gain the alternative taxes provided by Section 117(c)(1) of the Internal Revenue Code, and (b) in determining Petitioner's Excess Profits Tax liability and the deficiency therein for the year 1943 in failing to exclude from Petitioner's Excess Profits Net Income for said year under Section 711(a)(1)(B) of the Internal Revenue Code, as amended by Section 207(a) of the Revenue Act of 1942, said $181,196.25 as a long-term capital gain.

8. In affirming the Tax Court.

REASONS FOR GRANTING THE WRIT.

As to Error I: The container deposits were not received under a claim of right and the conclusion of the Court of Appeals that they were is in conflict with the decisions of this Court in the North American Oil Consolidated, Wilcox, Lewis and Healy cases, supra.

The only determination which the Commissioner of Internal Revenue made in his Notice of Deficiency with respect to the excess of deposits received on returnable containers over deposits refunded in the Petitioner's fiscal years ended in 1942 and 1943 was that such excess "should be included in your gross income." The only issue drawn by the pleadings was whether such excess of deposits received over those refunded in such two years was includible in Petitioner's *gross income* for such years *under Section 22(a)* of the Internal Revenue Code. Petitioner's averments of fact were to the effect that all of the container deposits received in the two years involved were true deposits, liabilities, and not includible in gross income. The Commissioner denied, *pro forma,* the averments of the Petition. He made no affirmative or other allegations as to any "reserve" in Petitioner's container deposit account, the adequacy or inadequacy thereof, whether the "reserve" was or was not "supported by any real liability" or that in his determination he "telescoped corrective procedures by leaving the reserve as it stood at the end of 1941 and treating as taxable income the entire net increase of deposits in 1942 and 1943" (R. 90).

In its determination the Tax Court begged the issue as drawn by the pleadings and made its determination on a question not even raised by the pleadings, namely, the

adequacy of the "reserve" for returnable containers in the two years involved. By its begging the issue drawn by the pleadings, the Tax Court held that the container deposits here in dispute, which it termed "a pledge or security for the return of the containers" (R. 8a) were *received under a claim of right and without restriction as to the disposition thereof.* That conclusion runs absolutely counter to reality, the undisputed facts herein supporting only a finding and conclusion that the amounts involved were *received as security deposits only,* not includible in gross income. That is the only reasonable inference; the contrary conclusion is clearly erroneous.

The record herein (R. 3a-7a; 10a-21a; 55a-75a) incontrovertibly shows that taxpayer's containers were not sold; the deposits were made to secure the return of them; the time of return was indefinite; the deposit was paid by the customer and received by Petitioner under specific written agreement; Petitioner expected the containers would be returned; the account was labeled "Deposits on Returnable Containers", showing the money entered was that of others; the tax returns for the taxable year involved called the account a liability; the stipulation of facts herein calls the money "deposits"; every fact in the record negatives any sale of the containers; and there were no book entries signifying the fact that Petitioner was closing out the transactions represented by the difference between the container deposits received and the refunds of container deposits made in each of the two taxable years here involved and putting the money deposited for them into its free funds. There was no "financial act" done by Petitioner in either of such taxable years which "created income", amounts equal to the excess of

container deposits over container refunds in the two taxable years involved being shown at all times during each of said years as liabilities of Petitioner to its customers, which amounts it was always ready, able and willing to pay to customers upon the return by them of Petitioner's containers.

The Court of Appeals in its Opinion likewise ignored the issue as raised by the pleadings and based its Decision upon the question set up by it as (R. 84) "whether, in the particular circumstances of this case, Section 41 of the Internal Revenue Code justified the Commissioner of Internal Revenue in making 'adjustments' of the Fort Pitt Brewing Company's gross income for 1942 and 1943, adding to income the amount of the net increase during each taxable year of the taxpayer's accounting 'Reserve for Returnable Containers'." As shown above, the Commissioner made no such adjustment under Section 41 and the conception of the Court of Appeals as to what the issue was is clearly erroneous. While it paid lip service to the fact that "a procedure of deposits and repayments is not designed for gain" (R. 86), nevertheless, upon *assumptions* of fact and its own "accounting theory" not supported by the Internal Revenue Code, the income tax regulations thereunder or court decisions, it went down the same clearly erroneous-in-law street as did the Tax Court.

Clearly, the excess of container deposits received over container deposits refunded in Petitioner's fiscal years ended in 1942 and 1943 were not received under a claim of right and without restriction as to the disposition thereof, and the determination of the Court of Ap-

peals otherwise conflicts with the decisions of this Court cited above and is clearly erroneous.

In *North American Oil Consolidated v. Burnet, supra,* this Court laid down the rule for determining when income is received and when it is required to be reported for tax purposes by the declaration that:

> "If a taxpayer receives *earnings* under a claim of right, and without restrictions as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money and even though he may still be adjudged liable to restore its equivalent."

This rule and reasoning were followed by this Court in its decisions in both *Commissioner v. Wilcox, supra,* and *United States v. Lewis, supra,* the Court in the Wilcox case stating (p. 48):

> "* * * a *taxable gain* is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain". (Emphasis supplied).

In the most recent decision of this Court dealing with the "claim of right" theory of income which counsel for Petitioner have been able to find, namely, *Healy, et al. v. Commissioner, supra,* the Court, through Mr. Chief Justice *Vinson,* stated:

> "The phrase 'claim of right' is a term known of old to lawyers. Its typical use has been in real property law in dealing with title by adverse possession, where the rule has been that title can be acquired

by adverse possession *only* if the occupant claims that he has a right to be in possession *as owner. The use of the term in the field of income taxation is analogous.* There is a claim of right where funds are *received and treated* by a taxpayer *as belonging to him."* (Emphasis supplied).

In a footnote to its Opinion in *Healy* this court stated:

> "14. The rule announced in *North American Oil v. Burnet,* supra, *requires a receipt* without 'restriction on use' *as well as under a claim of right."* (Emphasis supplied).

Thus, the law is clearly established that "earnings", or "income", must be received "without restriction on use" as well as under a claim of right, and that "There is a claim of right when funds are *received and treated* by a taxpayer *as belonging to him."* (Emphasis supplied).

To say that the container deposits here involved were "received and treated" by Petitioner "as belonging to him" is to completely disregard every fact in the record showing exactly the opposite. Every fact in the record negatives any sale of the containers. Petitioner did not part with title thereto upon receipt of the deposits. The deposits were made to secure the return of them. There was no time limit within which containers could be returned for refund. The deposits were made by customers and received by Petitioner under specific written agreement that they were to be returned. The Petitioner expected the containers would be returned, and refunds totaling 98.28% of deposits received in the fiscal year 1942 were made in that year and refunds of 96.95% of the deposits received in 1943 were made in that year. Petitioner's books showed the amounts involved as "de-

posits on returnable containers", showing the money entered was that of others; the stipulation of facts calls the money "deposits". The tax returns call the account a liability. There were no book entries signifying the fact that Petitioner was closing out the transactions represented by the difference between the deposits received and the refunds made in each of the two years involved and putting the money in its free funds. There was no "financial act" done by Petitioner in either of the taxable years which "created income", amounts equal to the excess of container deposits over container refunds in the two taxable years involved being shown at all times during each of said years as liabilities of Petitioner to its customers, and which amounts it was always ready, able and willing to pay to customers upon the return by them of Petitioner's containers.

In its erroneous conclusion that the excess of container deposits over container refunds in each of the two taxable years here involved "represented income to the Petitioner for Federal income tax purposes" (R. 8a) the Tax Court completely ignored (as did also the Court of Appeals) established State rules of property which it was bound to follow: *Warburton v. White,* 176 U.S. 484; *Standifer Construction Corp.,* 30 B.T.A. 184 (1934). Every dollar of container deposits which Petitioner received in its taxable years ended in 1942 and 1943 was received by it burdened by the obligation of return to its customers upon the return of the containers on account of which the deposits were made. Every dollar so received was recorded on Petitioner's books in its so-called "Reserve for Returnable Containers" account as funds belonging to its customers at all times during the two

years involved. Container deposits were received and container refunds were made by Petitioner on every business day in the two taxable years involved, with Petitioner standing ready, able and willing at all times during such years to return to its customers every dollar of container deposits which it received at any time prior thereto or in such years. How many dollars of container deposits Petitioner was going to receive in either of the two years involved or how many dollars of deposits it would refund in either or both of those years were matters entirely in the hands of its customers and completely beyond Petitioner's control. Petitioner knew that, under the Beverage License Law of the Commonwealth of Pennsylvania and the Regulations of the Liquor Control Board thereunder, it could only sell its products *upon receiving from customers* the container *deposits specifically required* by the Pennsylvania law to be made to it by its customers as to all containers holding not in excess of 128 fluid ounces, which requirement was complied with by Petitioner in the deposit agreement which it made with its customers covering all returnable containers at the time the customer bought Petitioner's products and took them away in Petitioner's property, *for the return of which containers the customer had made the specific deposits required by law and/or the written contract* with Petitioner. Petitioner had no more right in either of the taxable years involved *to ignore the property rights* of its customers in the container deposits which they had made in these taxable years *and expropriate the same* than the Tax Court had any right *in law* to say (R. 8a), that the excess of container deposits over container refunds in these two years, "represented income to the Petitioner for Federal income tax purposes

since the Petitioner was recovering or had recovered the cost of the containers through depreciation deductions."

To say as the Tax Court did in an attempt to justify its clearly erroneous-in-law conclusion that (R. 10a):

> "* * * It is immaterial that the Petitioner was compelled by state authority to require some deposits and to make disbursements when retainers were returned or that under state law it was not relieved, even in part, of its liability to make disbursements whenever containers were returned",

is to say that Petitioner *was required* at the end of each of its two taxable years here involved to violate the Beverage License Law of the Commonwealth of Pennsylvania and the Regulations of its Liquor Control Board as to the requirements for container deposits, the retention thereof by Petitioner for the accounts of its customers pending return of containers and the return of such deposits to its customers upon their returning the containers, and that, despite the fact that there was no time limit fixed by the agreement between Petitioner and its customers for the return of containers and the refund of deposits, that Petitioner was required at the end of each of the two taxable years here involved *to violate or breach every agreement for container deposits which it entered into in that year* where the customer had not returned the containers *by the end of that year,* in order that (R. 10a) "the Commissioner must [not] wait an *unreasonable* time, *perhaps indefinitely,* for *the collection of tax* on the amounts which *obviously* will not have to be repaid". (Emphasis supplied.) Certainly, there is no decision of any Court with which Counsel for Petitioner are familiar which makes the determination as to what constitutes

"income * * * for Federal income tax purposes" dependent upon any such arbitrary and unlawful process of reasoning. It is directly contrary to this Court's declaration in *North American Oil Consolidated* and its redeclarations in the *Wilcox, Lewis* and *Healy* cases as to what constitutes "income".

At all times in its years ended in 1942 and 1943 Petitioner treated *all* amounts of container deposits received by it as belonging to its customers, in accordance with the law of Pennsylvania and the agreements it had made with customers, and never at any time in either of said years did Petitioner "elect" or treat any part of such deposits as its property, nor did it transfer any part of such deposits to "free" funds. Petitioner had absolutely no control over its customers in the return of Petitioner's containers, but it did have the absolute requirement by law and by contract to return deposits on every container returned to it. There was a *definite present obligation to repay* and *not a mere possibility* of repayment. The *definite present obligation* to repay was avoidable only if Petitioner *should suffer damage* from future breach *by the customer*. Until action by the customer Petitioner was required by law and contract to hold inviolate the funds belonging to its customers. Yet, despite all these factors the Tax Court and the Court of Appeals tax to Petitioner *in the year of receipt* every dollar of container deposits received in such year in excess of container deposits refunded, *despite the fact that every such dollar was at all times held as funds belonging to its customers.*

While both the Tax Court and the Court of Appeals recognize that the deposits were a pledge or security for

the return of the containers (R. 8a; 84-91) they failed to recognize that security deposits do not represent gross income, as has been determined by the Tax Court and Courts of Appeals. *John Mantell,* 17 T.C. 1143; *Warren Service Corp. v. Commissioner,* 110 Fed. (2d) 723, affirming on this point and reversing on another, 39 B.T.A. 856; *Clinton Hotel Realty Corp. v. Commissioner,* 128 Fed. (2d) 968; *Estate of George E. Barker,* 13 B.T.A. 562; *Virginia Iron, Coal & Coke Co.,* 37 B.T.A. 195, aff'd. 99 Fed. (2d) 919, cert. denied, 307 U.S. 630.

By their determinations here, the Tax Court and the Court of Appeals necessarily hold that the security deposits were received under a claim of right and were subject to Petitioner's unfettered control. That conclusion runs absolutely counter to reality. There is no reason why the agreement between Petitioner and its customers as to the deposits cannot be taken for what it purports to be, and that is as one covering a security deposit only. The agreement was not a sale with an option to reconvey. The condition of repayment was an express and mandatory part of the written instrument under the terms of which the deposit was made by the customer and received by Petitioner. The undisputed facts support only a finding and conclusion that the amounts involved were received as security deposits only, and as such not includible in gross income. This is the only reasonable inference and the contrary conclusion of the Tax Court and Court of Appeals is clearly erroneous.

We submit that the record herein clearly shows, which fact the Tax Court and the Court of Appeals *completely ignored,* that not one dollar of the container de-

posits received by Petitioner in the two years here involved was received under a claim of right and without restriction as to the disposition thereof. Then and only then could such amounts represent amounts includible in gross income. *North American Oil Consolidated v. Burnet, supra; Commissioner v. Wilcox, supra; United States v. Lewis, supra,* and *Healy, et al. v. Commissioner, supra.*

As to Error II. The conclusion of the Court of Appeals that Petitioner's recording its container deposits received in its fiscal years ended in 1942 and 1943 as true deposits, liabilities, rather than as income did not properly reflect the transactions therein for income tax purposes is in conflict with the decision of the Court of Appeals for the Fifth Circuit in Wichita Coca-Cola Bottling Company v. United States, supra.

In *Osterloh v. Lucas,* 37 Fed. (2d) 277, C.A.A. 9, (1930), the Court stated:

> "* * * The case turns largely upon what is meant by the requirement that the method of accounting shall clearly reflect the income. * * * In our opinion, *all that is meant is that the books shall be kept fairly and honestly; and when so kept they reflect the true income of the taxpayer within the meaning of the law.* In other words, *the books are controlling, unless* there has been *an attempt of some sort to evade the tax.* This construction may work to the disadvantage of the taxpayer or the government at times, but if followed out consistently and honestly year after year, the result in the end will approximate equality as nearly as we can hope for

in the administration of a revenue law." (Emphasis supplied.)

Here, with the Commissioner's never having questioned whether Petitioner's books were fairly and honestly kept, the Tax Court and the Court of Appeals disregarded his acceptance of the method of accounting used by Petitioner in prior years as clearly reflecting its income for Federal income tax purposes on the container deposits and refunds in those years and with the method of accounting exactly the same in the years here involved as in such prior years, rejected the method of accounting used in the years 1942 and 1943 and placed Petitioner on a cash receipts and disbursements basis of accounting so far as container deposits and refunds are concerned. In other words, both the Tax Court and the Court of Appeals here *disregarded* Petitioner's *consistent method* of handling deposits and refunds in prior years and in the years here involved, and *accepted* the method in the prior years but *rejected* it in the two years involved. Putting it another way, both Courts *disregarded* the *undisputed fact* that the containers were *not* sold and treated all container deposits received in the tax years 1942 and 1943 as though they *involved sales of containers* and the refunds *purchases thereof*, directly contrary to the undisputed evidence.

In the Opinion of the Court of Appeals in the *Wichita* case, the Chief Judge of that Court said:

"* * * It is contended *for the United States* that the transactions over the years were not sales of bottles and cases, but loans of them *secured by deposits* of money *which stood open so long as the taxpayer was willing that they should stand open,*

but which *it could*, after a reasonable time for return, close out, and that *the book entires* signified *the fact* that taxpayer *was closing out* the transactions represented by the old balance and putting *the money deposited* for them *into its free* funds. * * *

"The Judge [District Court] found as a fact that *the cases were not sold* but that *deposits were made to secure returns of them, the time being indefinite*, and any person being allowed to return them. * * * *They were expected to be returned if not destroyed.* The *account was labeled* 'Deposits', *as if the money entered was that of others.* The *tax returns* all *called the account a liability. The stipulation* as above quoted *itself calls for* money *'deposits.'* If the balance was an aggregate *of old deposits* the *book entry closing them out and putting the money to free surplus* was not *mere bookkeeping*, but a *financial act*, * * *. *Such a financial act creates income in the year in which it is done.*" (Emphasis supplied.)

Here, there was no "financial act" done by Petitioner in either of such taxable years which "created income", amounts equal to the excess of container deposits over container refunds in the two years here involved being shown at all times during such years as liabilities of Petitioner to its customers, which amounts it was always ready, able and willing to refund to customers upon the return by them of Petitioner's containers.

In *Farmers Creamery Co. of Fredericksburg, Virginia*, 14 T.C. 879 (1950), the very Judge who heard the instant case and wrote the Opinion of the Tax Court therein, in that case found:

"The O.P.A. in 1942 required the Petitioner to obtain from its wholesale customers for 1943 and subsequent years deposits of three cents per bottle delivered to them, which deposits were to be returned to the customer with the return of the bottles. The bottles were not sold to the wholesale customers. The Petitioner kept a record of the deposits in a liability account and debited the refunds as made. * * *

"The Commissioner, in determining the deficiencies for 1943 and 1944, added to income $2,795.29 and $2,875.88, described as 'deposits on bottles,' and explained 'items reserved from income to meet contingent liabilities to refund deposits on milk bottles have been restored to taxable net income.' "

In its Opinion the Court said as to this action on the part of the Commissioner of Internal Revenue:

"The Respondent would have the Petitioner include in income the deposits on bottles as sales and then take deductions for the refunds. *There were not sales.* The Petitioner *chose* to record them *as true deposits, liabilities, rather than as income.* That method was in accordance with the nature of the deposits as required by the O.P.A. *and properly reflected the transactions for income tax purposes. Wichita Coca-Cola Bottling Co. v. United States,* 152 Fed. (2d) 6, Certiorari denied 327 U.S. 806. The Commissioner *had no right to depart from that accounting method merely to compute larger taxes for the period as a whole."* (Emphasis supplied).

But here both the Tax Court and the Court of Appeals *held* that the Commissioner of Internal Revenue *had the right* to depart from the method of accounting used by Petitioner "merely to compute larger taxes for the period as a whole." Clearly, we submit, their determinations are in conflict with the decision of the Court of Appeals for the Fifth Circut in the *Wichita* case and with the decisions of this Court in the four "claim of right" cases hereinabove cited, and clearly erroneous.

As to Errors 3, 4 and 5: These assignments (3) dealing with whether Section 41 of the Internal Revenue Code gives the Commissioner the right to create "gross income", (4) whether the Tax Court may base its determination upon a contention made by counsel for the Commissioner at the hearing before the Tax Court, unsupported by any pleading or issue drawn thereon, and (5) whether the Tax Court, on the basis of its determination that the excess of deposits received over deposits refunded in the two years involved represent gross income, may charge to Petitioner in such years amounts which on the Tax Court's own determination represent income applicable to years prior to those here involved, are so inter-related in the Court of Appeals' determination as to require their treatment here together.

Neither Section 41 of the Code, *infra,* p. 46, nor any of the cases cited by the Tax Court in support of its Opinion (See Petitioner's Motion for Reconsideration of Findings and Opinion Filed with the Tax Court, R. 34-40) give the Commissioner of Internal Revenue the right to "create" gross income. The record herein clearly shows that every dollar of container deposits which

Petitioner received in the two years here involved, whether returned to customers or not in such years, was upon receipt and thereafter in such years always coupled with an obligation to return to its customers, and that Petitioner fully recognized that obligation, as shown by its method of accounting for its customers' funds for which it was custodian.

In the *Wichita* case, *supra,* cited by the Tax Court in its Opinion, the facts with respect to the container deposits and refunds were similar to those in the instant case, and yet the only amount of container deposits (which had been accumulating for a number of years since 1919 and in 1940 were *transferred by the taxpayer* to its Surplus Account) added by the Commissioner and the Courts to the taxpayer's income was the amount of such deposits *so transferred by the taxpayer,* because that "financial act" *by the taxpayer* created income in the year in which it was done. *Here,* the Tax Court and the Court of Appeals erroneously concluded that the Commissioner of Internal Revenue had the right under Section 41 of the Code *to perform* that "financial act" and *change into income* in taxpayer's fiscal years ended in 1942 and 1943 amounts which taxpayer and its customers *agreed* in those years *belonged to the customers* and which Petitioner always held and showed in that manner in its books of account and for all purposes.

In *Boston Consolidated Gas Company,* 44 B.T.A. 793 (1941), aff'd. 128 F. (2d) 473 (C.C.A. 1st 1942), cited by the Tax Court, there was a burden upon the gas company to return deposits to customers *at the termination of contracts to supply them with gas.* No property of the gas company was held by the customer and no action

was required on the part of the customer to obtain a return of deposits paid. In that case deposits had been accumulating from prior to 1905 to 1935, the year involved, but it was only as to the amount which *the taxpayer* had credited to its Profit and Loss (Surplus) Account in 1935 which the Court determined represented income in the year in which *taxpayer* performed that "financial act", as a result of which the amount covered by such *credit to surplus* was made available for dividends and other corporate purposes, and thus, the Court held, the taxpayer realized in that year an accession to income within the intendment of Section 22(a) of the Revenue Act of 1934. *Here,* Petitioner had absolutely no control over its customers in the return of Petitioner's containers, but it did have *the absolute requirement* by law and by contract to return the deposit on every container on which it received a deposit. Yet, despite all these factors, the Tax Court and the Court of Appeals tax to Petitioner *in the year of receipt* every dollar of container deposits received in such year in excess of container deposits refunded, despite the fact that every such dollar was at all times *held by Petitioner as funds belonging to its customers.*

In *Nehi Beverage Company,* 16 T.C. 1114 (1951) the taxpayer transferred an amount from its deposit liability account to an income account, and the Court determined *the taxpayer* had done a financial act by closing out part of the deposit liability and putting the money into free surplus funds which created income. *Here,* the deposits were always recorded as liabilities and no part thereof was "closed out" to "free surplus funds". But despite this the Tax Court and the Court of Appeals

here concluded that since Petitioner's customers had not returned sufficient containers in each of the two years here involved to have permitted taxpayer to return an amount of container deposits equal to that which taxpayer's customers had deposited with it in each of those years (over which action or failure of action on the part of its customers Petitioner had no control whatsoever) that the *Commissioner of Internal Revenue* had the power to perform the "financial act" *necessary to change* funds held by taxpayer *as those of its customers* to *funds belonging to Petitioner without restriction in the year in which received.* There is no support in law for this unlawful reasoning.

In *Standifer Construction Corp., supra,* another case cited by the Tax Court, the Court found that the company was "obviously engaged *in the liquidation of its affairs* in that year [1927], and a fund *previously* held as impressed with an obligation and *becoming in that year available for other uses* is properly an item of income." (Emphasis supplied).

In *North American Coal Company,* 32 B.T.A. 535, aff'd. 97 F. (2d) 325, where the taxpayer had set up certain liabilities which it deducted from income and continued to carry on its books as liabilities even though the Statute of Limitations had run on the collection thereof, if the accounts were valid liabilities, all the taxpayer there had to do to show that was to pay them. Action *by it alone* was all that was required. *It held* the benefits received from its creditors and only had to disburse *its funds* in satisfaction of its liability. There, the taxpayer was free to do whatever it saw fit with those things *it acquired* from its creditors. *Here,* Peti-

tioner placed its property in the hands of its customers, who simultaneously therewith passed to Petitioner specific amounts of money *under written contract and in part under State law,* to be returned to the customers by Petitioner upon return by the customers to Petitioner of the latter's containers. Petitioner had no control over when its customers deposits in its hands were to be returned to them. That was in the customers' hands alone, without any time limit fixed therefor.

While the issue here as raised by the pleadings was whether the excess of deposits received on returnable containers over deposits refunded in each of the two years involved, "should be included in gross income", as the Commissioner determined, the Tax Court, based upon the contention made by Counsel for the Commissioner at the hearing, without any pleading upon which to base such contention or issue drawn thereon, turned the issue as raised by the pleading from one involving a question of "gross income" to one not raised by the pleadings and involving a question of the adequacy of a "reserve" and accordingly an item involving a deduction from "gross income". While the Tax Court did not state how it concluded that "the reserve at the end of 1943, after deducting the amounts included in income by the Commissioner," was "an ample amount" (R. 9a), it is plain that it disregarded the facts surrounding *the receipt* and *the holding* of the deposits in the two years involved and drew its conclusion neither upon the issue raised nor upon substantial evidence, but upon a contention of the Commissioner not covered by the pleadings and upon irrelevant evidence. Clearly, it erred as a matter of law in doing so.

The Tax Court did not state how it determined upon a reserve at the end of 1943, after deducting the amounts included in income by the Commissioner, of $219,864.64 as "an ample amount" (R. 9a). Taking into consideration, however, certain of the Court's findings and its conclusion that such a reserve at the end of 1943 was adequate, it can readily be seen, as shown on the following schedule, that approximately one-half of the "income" of $264,167.85 which the Tax Court charged to Petitioner on its determination represents "income" on that Court's determination *applicable to years prior to the fiscal years ended in 1942 and 1943* and thus *on the Tax Court's own reasoning not includible in income in those years.* The following schedule takes into consideration the conclusion of the Tax Court (R. 9a) that the annual average unreclaimed deposits over the period 1937 through 1951 was 1.15% of deposits received and the conclusion by that Court that a reserve of $219,864.64 would be adequate at the end of 1943. Putting it another way, the conclusion of the Tax Court that a reserve at the end of 1943 of $219,864.64 would be ample is the equivalent of that Court's concluding that the *exclusion from the reserve* each year, and thus includible in income, should be 1.15% of the deposits received.

RESERVE FOR RETURNABLE CONTAINERS
after excluding 1.15% of total deposits received each year.

Fiscal Year Oct. 31	Deposits Received	1.15% of Deposits	Excess of Deposits Over Refunds	Revised Add'n. to Reserve	Revised Reserve
					$ 17,962.50
1937	$ 842,464.25	$ 9,688.34	$ 10,284.50	596.16	18,558.66
1938	1,214,122.75	13,962.41	30,059.50	16,097.09	34,655.75
1939	2,381,485.50	27,387.08	45,734.85	18,347.77	53,003.52
1940	3,063,054.00	35,225.12	27,706.25	(7,518.87)	45,484.65
1941	3,998,938.27	45,987.79	88,117.04	42,129.25	87,613.90
Applicable to prior years		$132,250.74			
1942	$ 4,822,919.50	$ 55,463.57	82,971.60	27,508.03	115,121.93
1943	5,940,221.75	68,312.55	181,196.25	112,883.70	228,005.63
Applicable to 1942 and 1943		$123,776.12			
Total Adjustment		$256,026.86			
Adjustment by Commissioner (1942 and 1943 only)			$264,167.85		
Tax Court found Reserve adequate at Oct. 31, 1943					$219,864.64
Difference in credits in 7 years			$ 8,140.99		
Difference in Reserve in 7 years					$ 8,140.99

Thus, *on the Tax Court's reasoning* there would be income applicable to years prior to the two years here involved of $132,250.74, leaving $123,776.12 applicable to 1942 and 1943, and yet that Court taxes to Petitioner amounts totaling $264,167.85 in those years instead of approximately one-half of that amount *on its own theory of the issue involved* and its determination of what *it considered* an "adequate" reserve at the end of 1943.

Not only did the Tax Court, *on its own theory* of the case, thus err in determining the amounts of deposits *to be included* in "gross income" for the years 1942 and 1943, but it concluded that under Section 41 of the Internal Revenue Code the Commissioner had the right to make the adjustments to Petitioner's income which he made "where the method of accounting regularly employed by taxpayer, as here, does not clearly reflect its 'taxable income.' " (R. 9a). Despite the fact that Section 19.41-2 of Regulations 103 and Section 29.41-2 of Regulations 111 provided that, "Approved standard methods of accounting will ordinarily be regarded as reflecting income", with the same provision contained in Regulations 94 and 101 covering tax years back through 1937, and despite the fact that prior to the two years here involved the Commissioner did not question the method of accounting used by Petitioner in recording the deposits received and refunds thereof and can thus be assumed to have approved Petitioner's method of accounting therefor as "clearly reflecting income" (this same method of accounting having been used in all years from 1937 through 1951 (R 15a, 74a), the Tax Court concluded that Section 41 of the Code was authority for the Commissioner to include in income in the two years involved the

entire excess of deposits received over refunds made in those years, despite the fact that on that Court's reasoning of an "ample" reserve *a very substantial part* of that "income" *is applicable to years prior to those here involved.* In a recent decision of the Court of Appeals for the Third Circuit in *Commissioner of Internal Revenue v. Frame, supra,* in referring to the decision of the 8th Circuit in *Commissioner v. Mnookin, supra,* the Court of Appeals stated:

> "The discretion which the Commission has under Section 41 of the Code to make such computations as will clearly reflect income *does not empower him to add to the taxpayer's gross income for a given year an item which rightly belongs to an earlier year.*" (Emphasis supplied).

There is nothing in the Internal Revenue Code or the Commissioner's Regulations thereunder or in the decisions on the determinations of gross income for Federal income tax purposes which supports the "accounting theory" advanced by the Court of Appeals to support its conclusion (R. 84-91).

On its analization and rationalization of "the Commissioner's action" (R. 89) the Court of Appeals plainly concludes that the Commissioner included in Petitioner's income for its fiscal years ended in 1942 and 1943 container deposits *received* not in the fiscal years 1942 and 1943 but in prior years and having nothing whatever to do with deposits received in the years 1942 and 1943. It is clearly settled law, by the decisions of the Courts of Appeals cited in Assignment of Error 5 hereinabove, that the Commissioner of Internal Revenue may not add to a taxpayer's gross income for a given year an item belong-

ing to an earlier year. The "accounting theory" for the inclusion in Petitioner's gross income for the two years here involved of the excess of container deposits received in those years over deposits refunded therein enunciated in this case by the Court of Appeals is not only contrary to its declaration of the law in the *Frame* case, *supra*, but as well conflicts with the decisions of the other Courts of Appeals cited above on the same question, and is clearly erroneous. That the Court of Appeals recognizes (R. 91) that the "rather off-hand *device*" of *simply requiring* that the excess of deposits over refunds during the two years here involved be reported as income imposes a tax in those years on items of "income" *not received* in such years is shown by its statement that where the bookkeeping reserve for past years is not unreasonably large "thereafter *a small percentage of deposits received* itself will suffice without more to reflect *the income derived during the year* from dealings with containers." (Emphasis supplied).

Clearly, the decision of the Court of Appeals affirming the Tax Court which plainly shows *on the reasoning of both Courts* the inclusion in income in 1942 and 1943 of items *applicable to other years* not only shows "the Commissioner's result is unjust" (R. 91) but plainly that the Court of Appeals fails to follow the settled law that income attributible to one year may not be included in that of another, and thus its decision is clearly erroneous.

As to Errors 6 and 7: The Court of Appeals erred in failing to conclude, on the basis of the Tax Court's finding and conclusion that the excess of container deposits received over deposits refunded in the two years involved represented gross income, that the Tax Court committed reversible error (a) in failing to find and conclude that said excess of deposits received over deposits refunded represented gain from the sale, exchange or involuntary conversion of depreciable property held for more than 18 months as to the year ended October 31, 1942, and a recognized gain from involuntary conversion as the result of destruction of property used in the trade or business of Petitioner and thus a gain from the sale or exchange of capital assets held more than 6 months as to the year ended October 31, 1943, and (b) in failing to recompute accordingly in its Decision the deficiencies in taxes as determined by the Commissioner of Internal Revenue.

The deficiencies in taxes shown by the Tax Court's Decision are the same as the deficiencies in taxes shown in the Commissioner's Notice of Deficiency. In determining such deficiencies, the Commissioner included in Petitioner's gross income for Income and Excess-Profits Tax purposes for the fiscal years involved and as well for Declared Value Excess-Profits Tax purposes $82,971.60 and $181,196.25 as the excess of deposits received on returnable containers over deposits refunded on containers in the fiscal years 1942 and 1943, respectively.

The basis for the Tax Court's conclusion and Decision, as shown in its Opinion (R. 8a) is that "Petitioner had parted with some containers and had received money for them which it would not have to repay"; that "The

deposits were a pledge or security for the return of the containers"; that "it was an important inherent part of the arrangement that the deposit would be forfeited to compensate the Petitioner to some extent for the loss if the containers were not returned"; and that "since the Petitioner was recovering or had recovered the cost of the containers through depreciation deductions", "that money represented income to the Petitioner for Federal income tax purposes."

Thus, the Tax Court's conclusion was that Petitioner derived income gain or profit in the amounts of $82,971.60 and $181,196.25 through its having "parted with some containers" for which $82,971.60 and $181,196.25 were received. The containers were depreciable assets of Petitioner. Since the Tax Court charged to Petitioner as "Income * * * for Federal income tax purposes" the *entire amount* of the excess of container deposits over refunds in each of the two years involved, because it concluded that such amounts "obviously will not have to be repaid", because "the containers were not returned" and such deposits were forfeited "to compensate the Petitioner to some extent for the loss if the containers were not returned", the Tax Court thus concluded that Petitioner derived such "income" from the sale, exchange or destruction of some of its depreciable assets used in its business, and because it concluded that *all* of said excess of deposits over refunds in the two years involved "is taxable as income in those years" [despite its conclusion that such deposits were "to compensate the Petitioner to some extent for the loss if the containers were not returned"], it thus concluded that such containers on which such excess deposits over refunds were received represented *fully depreciated* containers, the

depreciation rates on which are shown in the record for the tax years here involved and prior thereto as 20% for bottles, 10% for cases and 5% for cooperage. (R. 8a, 6a, 73a).

Thus as to the fiscal year ended October 31, 1942, *based upon the Tax Court's conclusion,* it follows that Petitioner for Federal income tax purposes under the Internal Revenue Code (Appendix, *infra,* pp. 46-52) had income, gain or profit from the sale, exchange or involuntary conversion (as a result of destruction, in whole or in part, of depreciable property held for more than 18 months), and as to the fiscal year ended October 31, 1943, had a recognized gain from "involuntary conversion (as a result of destruction, in whole or in part) of property used in the trade or business" and thus a gain from the sale or exchange of capital assets.

For the Court of Appeals to conclude as it did (R. 91) that it disposes of taxpayer's argument "that the sums derived from deposits which were treated as income in 1942 and 1943 are subject to capital gains treatment" by stating that "the facts and findings in this record do not bring the gain in controversy within Section 117", is to further emphasize *the distortion* of Petitioner's income in 1942 and 1943 by the Tax Court and the Court of Appeals conclusions as above stated. The failure of the Court of Appeals to apply the provisions of the Internal Revenue Code (Appendix, *infra,* pp. 46-52 to the facts and findings in the record here [which show clearly that the Tax Court erred in failing to conclude, *on its own reasoning,* that the excess of deposits received over deposits refunded in the fiscal year 1942 represented gain from the sale, exchange or in-

voluntary conversion of depreciable property held more than 18 months and thus to be excluded from Petitioner's Excess Profits Net Income in determining its Excess Profits Tax liability and any deficiency therein for 1942, and that the excess of deposits received over deposits refunded in the fiscal year 1943 represented a recognized gain from involuntary conversion as the result of destruction of property used in the trade or business of Petitioner and thus a gain from the sale or exchange of capital assets held more than 6 months and to be taken into consideration as such in determining Petitioner's Income and Declared Value Excess-Profits Tax liability and any deficiency therein and to be excluded from income in determining Petitioner's Excess Profits Net Income and its Excess Profits Tax liability and any deficiency therein for 1943] is clearly erroneous. The facts and findings *to require* so-called "capital gains treatment" of the excess of deposits received over deposits refunded in the two years here involved in the determination of Petitioner's tax liability for said years are in the record here and when the Tax Court and the Court of Appeals ignore them they deprive taxpayer of the equal protection of the law to which it is entitled and thus err as a matter of law. There can be no doubt that the Tax Court's determination of taxable income and the Court of Appeals' affirmance thereof were *on the theory* that containers in a dollar amount at least equivalent to the deposits added to income *were not returned or were destroyed or lost,* and thus involuntarily converted (Appendix, *infra*).

Clearly, based on "the facts and findings in this record", on the Tax Court's and the Court of Appeals' "rea-

soning" and under the statutory law and the Commissioner's regulations, *infra,* pp. 46-52, there is everything in the record herein, on the basis of the Tax Court's findings and conclusion, *to require* the application of what is here termed so-called "capital gains treatment" to the excess of container deposits over refunds added to income in the two years here involved.

Conclusion.

For all of the reasons above stated, the Court of Appeals erred in affirming the Tax Court and this Petition for Writ of Certiorari should accordingly be granted.

Respectfully submitted,

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April, 1954.

APPENDIX.

Internal Revenue Code (26 U.S.C. 1946 Ed.):

Sec. 22. Gross Income. [Applicable to both years involved].

(a) *General definition.*—"Gross income" includes gains, profits, and income derived * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Sec. 41. General Rule. [Applicable to both years involved].

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computations shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

Sec. 117. Capital gains and losses.

* * * * * * *

(c) *Alternative taxes.*—

(1) *Corporations.* — If for any taxable year the net long-term capital gain of any corporation ex-

ceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207(a)(1) or (3), and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 25 percentum of such excess.

* * * * * * *

(j) *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, * * * which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, * * *) of property used in the trade or business and capital assets held for more than 6 months into other property or

money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six months. * * *

Sec. 711. Excess Profits Net Income. [As amended by Sec. 208 of the Revenue Act of 1942—Applicable to year ended October 31, 1942].

(a) *Taxable years beginning after December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal tax net income, as defined in section 13(a), (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * * * *

(B) *Long-Term Gains and Losses.*—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of the recognized gains from the sale, exchange, or involuntary conversion (as a result of destruction in whole or in part, * * *) of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23 (l) over the recognized losses from the sale, exchange, or involuntary conversion of such property. * * *

Sec. 711. Excess profits Net Income. [As amended by Sec. 207(a) of the Revenue Act of 1942—Applicable to the year ended October 31, 1943].

(Same as above except sub-paragraph (B) provides as follows):

(B) *Gains and losses from sales or exchanges of capital assets.*—There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months;

* * * * * * *

Section 208 of the Revenue Act of 1942 provides:

"Effective with respect to taxable years beginning after December 31, 1939, but not beginning after December 31, 1941, the second sentence of Section 711(a)(1)(B), Section 711(a)(2)(D), and Section 711(b)(1)(B) is amended to read as follows: 'There shall be excluded the excess of the recognized gains from the sale, exchange, or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property held for more than 18 months which is of a character which is subject to the allowance for depreciation described in Section 23(l) over the recognized losses from the sale, exchange, or involuntary conversion of such property. For the purposes of this subparagraph, Section 117 (h)(1) and (2) shall apply in determining the period for which the taxpayer has held property which is of a character which is subject to the allowance for depreciation provided in Section 23(l).'"

The Senate Finance Committee report on the 1942 bill treating of Section 208 quoted above stated:

"This section [208] for which these is no corresponding provision in the House Bill, provides that gains and losses *on the involuntary conversion of property of a character subject to the allowance for depreciation provided in Section 23(l),* held for more than 6 months, shall be treated *for excess profits tax purposes* the same as gains and losses from the sale or exchange of such property. *Under this amendment* the excess of gains from such sales, exchanges, and involuntary conversions over the losses therefrom *is excluded from excess profits net income. For the purposes of this Section,* property is *involuntarily converted* if it is *destroyed in whole or in part, stolen, seized, requisitioned, or condemned.* For example, if a taxpayer has a gain of $1,000 from the sale of property of a character subject to the allowance for depreciation provided in Section 23(l), held for more than 6 months, a gain of $8,000.00 from insurance on such property which was destroyed by fire, or $1800 of gain, and a loss of $600 from the total destruction by fire of such property which was not insured, the excess of $1800 over $600 *is excluded from excess profits net income.* This Section also provides that the determination of the period for which such property has been held shall be made under the same provisions as are applicable in determining the holding period of capital assets under Section 117.

"This amendment is applicable only to taxable years beginning after December 31, 1939, *and not*

beginning after December 31, 1941. The amendments made by Sections 153 [changed to 151 in conference] and 207 of the Bill, *applicable to taxable years beginning after December 31, 1941,* make it unnecessary to enact similar provisions with respect to taxable years beginning after December 31, 1941."

Regulations:

Reg. 103, *Sec.* 19.22(a)-1. *What included in gross income.*—Gross income includes in general * * * business income, profits from sales of and dealings in property, * * * and gains, profits, and income derived from any source whatever, unless exempt from tax by law. * * * In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

Sec. 19.22(a)-5. *Gross income from business.*—In the case of a manufacturing, * * * business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold. * * *

Sec. 19.41-2. *Bases of computation and changes in accounting methods.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items

of gross income and all deductions are treated with reasonable consistency. * * *

Sec. 19.41-3.—*Methods of Accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. * * *

Regulations 111, Sections 29.22(a)-1, 29.22(a)-5, 29.41-2 and 29.41-3 are similar to the provisions of Regulation 103 set forth above.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 689

FORT PITT BREWING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3a-10a) are reported in 20 T. C. 1. The opinion of the Court of Appeals (R. 84-91) is reported at 210 F. 2d 6.

JURISDICTION

The judgment of the Court of Appeals was entered on February 11, 1954. (R. 92.) The petition for a writ of certiorari was filed on April 15, 1954. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in holding that the excess of deposits received over refunds made on returnable containers was properly included in taxpayer's income for the taxable years 1942 and 1943 pursuant to Section 41 of the Internal Revenue Code.

2. Whether the Court of Appeals, on the record in this case, erred in holding that the sums derived from deposits which were treated as income in the years 1942 and 1943 were not subject to capital gains treatment under Section 117 of the Internal Revenue Code.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra,* pp. 11-15.

STATEMENT

The facts, as found by the Tax Court (R. 3a-7a) and as stipulated (R. 10a-16a), may be summarized, as follows:

Taxpayer, a corporation, operates breweries located at Sharpsburg and Jeannette, Pennsylvania. It required pursuant to Pennsylvania law (R. 11a-13a) that the purchasers of its products deposit with it various amounts for the return of the containers in which it delivered its products, the deposit in each case being somewhat less than the cost of the container. Taxpayer's invoices specified that the containers would remain the absolute property of taxpayer and that the deposit would be repaid only on return of the container. No time

limit was specified by taxpayer within which the containers were required to be returned for refund of the deposit. (R. 3a-4a.) Taxpayer kept no records to show the number or type of returnable containers which were outstanding or the names of those who held the unreturned containers (R. 6a-7a).

The deposits received by taxpayer were placed in its general cash fund (R. 7a) and were mingled with its other funds (R. 8a). Taxpayer maintained on its books a liability account entitled "Reserve for Returnable Containers" wherein it credited the deposits received and debited the refunds made. Refunds paid during 1942 were $82,971.60 less than the deposits received, and in 1943 the refunds were $181,196.25 less than the deposits. (R. 4a-5a.) No amount represented in the reserve account was ever reported by taxpayer as income (R. 7a). Taxpayer maintained a separate account for the cost of returnable containers and set up reserves for depreciation thereon. The entire cost of its containers has been or is being taken by taxpayer as deductions for depreciation on its income tax returns. The experience of taxpayer with its Reserve for Returnable Containers account made it obvious that many containers would never be returned, and that taxpayer would never be called upon to refund or disburse a substantial portion of its bookkeeping reserve for the unreturned containers. (R. 5a, 8a.)

The Commissioner, in determining deficiencies in taxpayer's income taxes for the years 1942 and 1943, added to the income disclosed by taxpayer's

returns, the sum of $82,971.60 for 1942 and $181,196.25 for 1943 representing the unrefunded deposits carried in taxpayer's reserve accounts for those years (R. 7a).

The Tax Court sustained the deficiencies, holding that the adjustments made by the Commissioner were not unreasonable or unjustified (R. 10a). Subsequently, taxpayer filed a motion to vacate the decision on the ground that the excess deposits over refunds were subject to capital gains treatment under Section 117 of the Internal Revenue Code, which was denied by the Tax Court (R. 43a-47a). The Court of Appeals affirmed (R. 91).

ARGUMENT

1. Taxpayer's contention that the container deposits involved were not earnings received by it under a claim of right, and that the decision of the court below sustaining the inclusion of a portion of such deposits in its income, is, for that reason, at variance with this Court's decision in *North American Oil Consolidated* v. *Burnet,* 286 U. S. 417, has no merit.

The Commissioner did not, of course, include in taxpayer's income all of the deposits received by it, but only an amount for each year essentially equivalent to the portion of such deposits which would never have to be returned. As noted (p. 3, *supra*), the taxpayer deducted the entire cost of its containers. Both courts below found (R. 8a, 87) that taxpayer's experience made it obvious that a substantial portion of the container deposits received from its customers would never have to be

returned, and that taxpayer was, therefore, under no obligation to return them. In the circumstances taxpayer clearly received, under a claim of right and without restriction as to its disposition, that portion of the deposits which would never be returned. The *North American* decision holds that "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income * * *, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." 286 U. S. 424. "[I]f the unconditional indebtedness is cancelled or retired, taxable income may adhere." *Commissioner* v. *Wilcox,* 327 U. S. 404, 408. "There is a claim of right when funds are received and treated by a taxpayer as belonging to him." *Healy* v. *Commissioner,* 345 U. S. 278, 282. In the circumstances, the decision of the court below holding that the deposits which would never be refunded were income to taxpayer, is not in conflict with the *North American* decision or any other decision of this Court, but on the contrary, is in accord with this Court's rulings.[1]

It has been held that unrefunded deposits, where the taxpayer himself posted them in his books to surplus or profit and loss accounts, are taxable in-

[1] In view of the taxpayer's relation to the excess deposits, the discussion in the petition (Pet. 23) concerning taxpayer's obligation, imposed by state law and under its contracts with customers, to refund all of the deposits, and the reference to property rights under state law, are irrelevant to the issues presented by the instant case. Cf. *Burnet* v. *Harmel,* 287 U.S. 103, 110; *Helvering* v. *Stuart,* 317 U.S. 154, 161.

come in the year they are so posted. *Wichita Coca Cola Bottling Co.* v. *United States,* 152 F. 2d 6 (C. A. 5), certiorari denied, 327 U. S. 806; *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C. A. 1). See also *Nehi Beverage Co.* v. *Commissioner,* 16 T. C. 1114. But it does not follow that there is no income merely because the taxpayer chooses to delay making the entry or to decline to make it at all. Obviously, it is not within the uncontrolled will of the taxpayer to postpone indefinitely or to immunize entirely from taxation amounts that are otherwise taxable income under the law. The discretion placed in a taxpayer by Section 41 of the Internal Revenue Code, *infra,* pp. 11-12, to employ its own method of accounting does not in any way permit a taxpayer to distort his income. Section 41 makes this clear. It provides that "if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income."[2] Consequently, the Commissioner was fully authorized to compute the taxpayer's income in a manner that would clearly reflect the income, and that could be done in this case only by includ-

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[2] Section 29.41-1 of Treasury Regulations 111, promulgated under the Internal Revenue Code, provides in part that:

> The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income.

ing in the income a reasonable portion of the unrefunded deposits.[3]

Both courts concurred in the findings of fact that a substantial portion of the container deposits would never be refunded (R. 8a, 87) and that the amounts added by the Commissioner to taxpayer's income were reasonable (R. 9a-10a, 90-91). The settled rule of this Court makes concurrent findings of two courts below final here in the absence of exceptional error. *Comstock* v. *Group of Investors,* 335 U. S. 211, 214. The findings here are fully supported by the evidence.

Taxpayer's account entitled, "Reserve for Returnable Containers" (R. 4a-5a) shows unquestionably that over a period of years a substantial portion of the deposits would never be refunded. And in concluding that the amounts added by the Commissioner to taxpayer's income were reason-

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[3] There is no conflict, as asserted by taxpayer (Pet. p. 14), between the decision of the court below and *Commissioner* v. *Frame,* 195 F. 2d 166 (C.A. 3); *Commissioner* v. *Mnookin's Estate,* 184 F. 2d 89 (C.A. 8); *Commissioner* v. *Schuyler,* 196 F. 2d 85 (C.A. 2); *Welp* v. *United States,* 201 F. 2d 128 (C.A. 8); *Caldwell* v. *Commissioner,* 202 F. 2d 112 (C.A. 2); and *Commissioner* v. *Dwyer,* 203 F. 2d 522 (C.A. 2). In those cases the Commissioner was held to be without authority to add to income, in a given year, amounts accruing prior to that year or to adjust income to include amounts erroneously taken as deductions in prior years. But in the case at bar, he did not include amounts of that character. He treated as income only the excess of deposits over refunds in each of the taxable years and left undisturbed the excess deposits placed in reserves during the prior years.

able in the circumstances, both courts below pointed out (R. 9a-10a, 90-91) that the total added by the Commissioner to taxpayer's income was approximately the same amount as would have been added had the taxpayer from the beginning properly treated as income a percentage of the total deposits which, based on experience, would have remained unclaimed.[4] Hence, there was no error in the findings of the two courts below, and review by this Court is not warranted.

2. Taxpayer's contention (Pet. 41-45) that the unrefunded container deposits received by it were subject to capital gains treatment under Section 117 of the Internal Revenue Code, *infra*, pp. 12-14, was disposed of by the court below (R. 91) with the statement that the facts and findings in this record do not bring the gains in controversy within Section 117. The court, however, expressly left open the question whether capital gains treatment in this type of case would be justified on a different record.[5] Thus, the court's decision on this

[4] The reference made by the courts below to prior years was made only for the purpose of determining the propriety of the Commissioner's adjustments of taxpayer's accounts to clearly reflect taxpayer's income in 1942 and 1943. The Commissioner did not include in the adjustments income received in prior years, nor did the courts below indicate that he did or should have done so.

[5] This disposition of the question was in all likelihood suggested to the court below by the fact that the record fails to show that the question was presented to or passed upon by the Tax Court at the trial of the case. The record shows merely (R. 43a-47a) that after the Tax Court's final decision was entered, taxpayer filed a motion to vacate the decision on the ground that the Tax Court had failed to accord capital gains treatment to the unrefunded deposits. The Tax Court denied the motion (R. 2a), but the record is silent as to why it did so.

question is confined to this particular case, and does not, therefore, present a question warranting review by this Court.

We submit that there was ample basis in the present record for the holding on this question by the court below. The term "capital assets", as defined in Section 117(a)(1) of the Internal Revenue Code, *infra*, pp. 12-13, does not include "property held by the taxpayer primarily for sale to customers", or "property, used in the trade or business, of a character which is subject to the allowance for depreciation provided for in section 23(l)." Thus, the containers involved in this case, on the present record, would not be "capital assets" even if the deposit transactions were sales. And since taxpayer's containers were used in its business and their cost was deducted in full, they are likewise excluded from that term.

Nor would the containers be property used in trade or business and subject to capital gains treatment under Section 117(j) of the Internal Revenue Code,[6] *infra*, pp. 13-14, since, as the court below stated, they were at all times carried in taxpayer's inventory. And it is equally clear that the unrefunded deposits would not be subject to capital gains treatment as gains from involuntary conversion as a result of destruction in whole or in part of property held for specified lengths of time.

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[6] Subsection (j) of Section 117 was added to the Internal Revenue Code by Section 151(b) of the Revenue Act of 1942, 56 Stat. 798, and was made effective as to taxable years beginning after December 31, 1941. It would not apply to taxpayer's income taxes for 1942.

The record does not allocate the deposits which were in excess of refunds to any particular containers, nor does it disclose how long any designated returnable containers were used in the business. While it is reasonable to presume that some containers were lost or destroyed, the record throws no light on the quantities involved in the presumed loss or destruction.

CONCLUSION

The decision of the court below is correct, and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MAY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as

defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1946 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 43.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a

character which is subject to the allowance for depreciation provided in section 23(l); * * *

* * * * *

(j) [As added by Sec. 151, Revenue Act of 1942, c. 619, 56 Stat. 798] *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered

as gains and losses from sales or exchanges of capital assets held for more than 6 month. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

SEC. 711 [As added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning after December 31, 1939.*— The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(B) [As amended by Sec. 208, Revenue Act of 1942, *supra*] * *Long-term Gains and Losses.* —There shall be excluded long-term capital gains and losses. There shall be excluded the excess of the recognized gains from the sale,

* Effective with respect to taxable years beginning after December 31, 1939, but not beginning after December 31, 1941, (Sec. 208, Revenue Act of 1942, *supra*).

exchange, or involuntary conversion (as a result of destruction in whole or in part, * * *) of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23(l) over the recognized losses from the sale, exchange, or involuntary conversion of such property. * * *

(26 U.S.C. 1946 ed., Sec. 711.)

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 207. CAPITAL GAINS AND LOSSES IN THE COMPUTATION OF EXCESS PROFITS NET INCOME.

(a) *Excess Profits Credit Computed under Income Credit.*—Section 711 (a) (1) (B) is amended to read as follows:

"(B) *Gains and Losses from Sales or Exchanges of Capital Assets.*—There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months."

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(26 U.S.C. 1946 ed., Sec. 711.)

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